

STATE OF IOWA
DEPARTMENT OF COMMERCE
UTILITIES BOARD

IN RE: DEREGULATION OF LOCAL EXCHANGE SERVICES IN COMPETITIVE MARKETS	DOCKET NO. INU-04-1
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FINAL DECISION AND ORDER

(Issued December 23, 2004)

BACKGROUND

It is the policy of the state of Iowa that communications services should be available throughout the state, from a variety of providers, at just and reasonable rates. Iowa Code § 476.95(1). This policy was formally adopted by the state of Iowa in 1995. When sufficient providers enter a market, such that effective competition exists, the Utilities Board (Board) is required to deregulate that market. Iowa Code § 476.1D. Even before the state enacted § 476.1D, the Board acted to further telecommunications competition in Iowa by deregulating a number of telecommunications services.¹ The Board continued deregulating certain telecommunications services after passage of § 476.1D.²

¹ See "Order Adopting Rules," In re: Rules Regarding Treatment of Costs Associated with Inside Wiring, etc., Docket No. RMU-81-19, issued October 8, 1982; "Order Adopting Rules," In re: Deregulation of the Terminal Equipment Market, Docket No. RMU-82-1, issued February 9, 1983.

² See "Order Adopting Rules," In re: Terminal Equipment—Amendments to Chapters 22 and 16, Docket No. RMU-85-6, issued July 26, 1985 (deregulating pay telephones); "Order," In re: Northwestern Bell Telephone Co., Docket No. RPU-84-8, issued September 5, 1984 (deregulating Centrex services and certain private line services); In re: Investigation Into the Competitiveness of Versanet Service, Docket No. INU-85-5; In re: Mobile Telephone Service and Paging Service, Docket No. INU-86-2; In re: Intrastate Billing and Collection Service Tariffs, Docket No. INU-88-10; In re:

Nationally, the local telecommunications market was opened to competition in the year following the enactment of Iowa's statute (Iowa Code § 476.95 et seq.) with the federal Telecommunications Act of 1996 (the Act). The Act mandated that each telecommunications carrier has the duty to interconnect with other carriers.³ The Act allows competitive local exchange carriers (CLECs) to resell the retail services of the incumbent local exchange carriers (ILECs), to use the ILEC's facilities (in whole or on a piece-by-piece basis⁴), or to build their own facilities. The Act also requires each LEC to provide number portability, the provision of dialing parity, access to its poles, ducts, conduits, and rights-of-way, and the establishment of reciprocal compensation arrangements for the transport and termination of telecommunications.⁵ In addition, the Act requires all ILECs to negotiate agreements regarding the resale of its telecommunications services, provide interconnection, to provide unbundled access (through UNEs), to offer its services for resale, and to collocate equipment necessary for interconnection.⁶

Many CLECs in Iowa rely upon the ILEC's wholesale services to provide some or all of their own retail services. In other words, these CLECs "rent" the ILEC's

Deregulation of InterLATA Interexchange Message Telecommunications Services, etc., Docket No. INU-88-2; In Re: Deregulation of Touch Calling and Custom Calling Features, Docket No. INU-88-8; In Re: Deregulation of Recording Function of Billing and Collection Services, Docket No. INU-88-9; In Re: Deregulation of Competitive IntraLATA Interexchange Services, etc., Docket No. INU-95-3; and In Re: U S West Communications, Inc., n/k/a Qwest Corporation, Docket No. INU-00-3.

³ 47 U.S.C. § 251(a)(1).

⁴ A CLEC could lease separate unbundled network elements (UNEs) or the entire UNE-platform (UNE-P) from the ILEC.

⁵ 47 U.S.C. § 251(b).

⁶ 47 U.S.C. § 251(c).

facilities, namely the UNE or the entire UNE-platform (UNE-P), from the incumbent. The CLEC then uses those rented facilities to offer service to customers. This relationship appears to form the basis for much of the local exchange telecommunications competition in Iowa.

On August 4, 2003, the Board initiated a comprehensive industry-wide survey to obtain an overview of the status of local exchange telecommunications competition in Iowa. The survey was sent to approximately 280 companies that provided, or had the potential to provide, local telephone service in Iowa. A total of 239 telephone service providers, including 93 percent of the wireline carriers, responded to the survey. The survey results were described in a report issued January 26, 2004.

The survey results indicated that despite the large number of local exchange service providers in Iowa,⁷ competitive local exchange service was not universally available as of the survey date. While some customers in Iowa's urban exchanges had multiple choices for their local exchange service provider, there was little or no competitive choice in most rural exchanges (although there were exceptions). Further, while competition for local exchange service appeared to be increasing, the incumbent providers continued to serve the majority of the customers in the state.

Moreover, the survey indicated that incumbent companies retained a significant market share when measured on a statewide basis. However, the survey

⁷ One hundred sixty-one of these telecommunications service providers are ILECs that generally do not compete against each other; instead, they concentrate their efforts on their own separate service territories.

also showed that competitive telecommunications providers catering to certain customer classes were making strides in some exchanges. Similarly, in some of the exchanges, certain CLECs had successfully constructed their own wireline networks. It appeared that these "overbuilt" markets may represent a different situation altogether, leading to the notion that competition should be examined on a basis other than statewide. Specifically, it became apparent that local exchange competition should be considered on an exchange-by-exchange basis.

Finally, the survey data also indicated that customers in certain specific geographic areas or certain customer groups had a choice of providers. With this apparent increase in telecommunications competition in some areas, the Board concluded it was appropriate to examine certain specific markets more closely.

Therefore, the Board initiated this proceeding on its own motion, pursuant to Iowa Code § 476.1D (2003) and 199 IAC 5.3(1) (2003) and identified as Docket No. INU-04-1, to consider whether local exchange service to business customers in Sioux City, business and residential customers in Council Bluffs, and other specific Iowa communities where the CLEC has constructed its own facilities and has acquired a market share greater than 50 percent for both business and residential customers (known as the "overbuilt exchanges") is subject to effective competition and should be deregulated. The Board also proposed to consider whether residential second line service throughout Iowa is subject to effective competition and should be deregulated.

Facilities-based competition, rather than UNE-P, has been the focus of this proceeding. Currently, there is regulatory uncertainty at the federal level regarding the future of UNE-P. In August 2003 the Federal Communications Commission (FCC) issued its Triennial Review Order (TRO),⁸ wherein the FCC found that if an ILEC can show three or more CLECs are using their own facilities, in whole or in part, to compete with the incumbent, then the incumbent should no longer be required to offer UNE-P to its competitors in that market. A three-judge panel of the D.C. Circuit Court of Appeals, upon review of this portion of the TRO, found that the FCC erred in maintaining competitors' mass-market access to unbundled switching and inter-office transport.

On August 20, 2004, the FCC released interim rules that called for a six-month standstill period for interconnection agreements in effect as of June 15, 2004 to allow the FCC time to develop final rules. Since August 20 the FCC has adopted those final rules, but has not yet issued a final written order.⁹ Because of this regulatory uncertainty during the course of these proceedings, the Board did not consider UNE-P-based competition, by itself, as a basis for deregulation in this initial phase of this proceeding. A consideration of competitors that use UNE-P and other UNEs will

⁸ *In the Matter of Review of the Section 251 Unbundling Obligations of Incumbent Local Exchange Carriers; Implementation of the Local Competition Provisions of the Telecommunications Act of 1996; Deployment of Wireline Services Offering Advanced Telecommunications Capability*, CC Docket Nos. 01-338, 96-98, and 98-147, "Report and Order on Remand and Further Notice of Proposed Rulemaking." (Rel. August 21, 2003).

⁹ *See FCC Adopts New Rules for Network Unbundling Obligations of Incumbent Local Phone Carriers*, FCC Press Release (Dec. 15, 2004) (eliminating unbundled access to mass market circuit switching and unbundled network element platforms (UNE-Ps) while retaining unbundled access to high-capacity loops and transports).

likely be addressed in a future phase of the Board's ongoing deregulation process. At that time, there should be better information available as to whether the competition currently provided through UNE-P is sustainable and should be included in the analysis.

PROCEDURAL HISTORY

On May 7, 2004, the Board initiated this notice and comment proceeding to consider deregulation of local exchange service in certain Iowa communities and residential second line service throughout Iowa. Specifically, the Board requested comments regarding the following issues:

1. Proposed deregulation of business and residential local exchange service in the Council Bluffs market;¹⁰
2. Proposed deregulation of business service in the Sioux City market;¹¹
3. Proposed deregulation of all local exchange service in the following twenty-two overbuilt communities: Armstrong, Belle Plaine, Conrad, Coon Rapids, Delmar, Forest City, Harlan, Laurens, Lowden, Mapleton, Oxford, Oxford Junction, Primghar, Saint Ansgar, Solon, Spencer, Stacyville, Stanwood, Steamboat Rock, Storm Lake, Tiffin, and Whiting; and

¹⁰ For purposes of this proceeding, the Council Bluffs market also includes the following communities: Loveland and Wilson.

¹¹ For purposes of this proceeding, the Sioux City market also includes the following communities: James and Westfield.

4. Proposed deregulation of residential second lines throughout Iowa.

In the May 7 order, the Board also required that all ILECs and CLECs providing service in the Council Bluffs and Sioux City markets, as well as the ILECs and CLECs providing service in the listed overbuilt communities, file updated responses to the Board's 2003 telecommunications competition survey. This information would serve two purposes: first, it would give a more updated snapshot of the competitive status of each exchange; second, the updated results in 23 exchanges would provide an indication of how much the market had changed between the time of the 2003 survey and the time of the updated responses. This information would, in turn, allow the Board to evaluate the continuing validity of the original survey. The appropriate carriers submitted updated responses as requested. The responses show that in the majority of these exchanges, which should be the most competitive in the state, the ILEC's market share changed by less than 3 percentage points between the survey results in 2003 and 2004. In fact, the change in ILEC market share exceeded 5 percentage points in only five of the 23 exchanges and exceeded 10 percentage points in only one exchange. Based on this information, it is reasonable to conclude that the 2003 survey results are still reliable.

Sixteen participants filed written statements of position and counterstatements of position pursuant to the Board's procedural schedule established in the May 7 order. Participants include: AT&T of the Midwest, Inc., and TCG Omaha, Inc.

(collectively, AT&T); Cedar Communications (Cedar); Cox Iowa Telcom, LLC (Cox Iowa); Farmers' and Business Men's Telephone Company, d/b/a F&B Communications (F&B); FiberComm, Inc. (FiberComm); Forest City Telecom, Inc. (Forest City); Frontier Communications of Iowa, Inc. (Frontier); Iowa Association of Municipal Utilities (IAMU); Iowa Telecommunications Association (ITA); Iowa Telecommunications Services, Inc., d/b/a Iowa Telecom (Iowa Telecom); Lost Nation – Elwood Telephone Company (Lost Nation); McLeodUSA, Inc. (McLeod); Qwest Corporation (Qwest); Rural Iowa Independent Telephone Association (RIITA); South Slope Cooperative Telephone Company, Inc. (South Slope); and the Consumer Advocate Division of the Department of Justice (Consumer Advocate).

Oral presentations in this proceeding were held on August 24, 2004, for the purpose of cross-examining witnesses on the subject matter of the Board's May 7 order and on their statements and counterstatements of position. AT&T, Cedar, Cox Iowa, F&B, Frontier, Forest City, IAMU, Iowa Telecom, Lost Nation, South Slope, McLeod, Qwest, and Consumer Advocate attended.

On October 4, 2004, briefs were filed by Cox, F&B, Forest City, Frontier, IAMU, Iowa Telecom, Lost Nation, McLeod, South Slope, Qwest, and Consumer Advocate, pursuant to the Board's briefing schedule established by order issued September 9, 2004. In lieu of reply briefs, the Board gave these participants an opportunity to present oral argument regarding the issues discussed in the initial

briefs. Oral arguments were presented to the Board on October 19, 2004, in the Board's hearing room.

APPLICABLE LEGAL STANDARDS

Iowa Code § 476.1D(1) (2003) provides for deregulation of communications services if the Board determines that the services are subject to effective competition. In making that determination, the Board must consider, among other factors, (1) whether a comparable service or facility is available from a supplier other than the regulated telephone utility and (2) whether market forces are sufficient to assure just and reasonable rates without regulation. The Board has the option of deregulating rates but continuing service regulation if it determines the service is an essential communications service and the public interest warrants continued service regulation, pursuant to § 476.1D(5).

The Board has promulgated rules to aid in determining whether a service or facility is subject to effective competition. Subrule 199 IAC 5.6(1) provides that the Board may consider the following criteria when making this determination:

- a. The ability of a single provider to determine or control prices;
- b. The ease with which other providers may enter the market;
- c. The likelihood that other providers will enter the market;
- d. The substitutability of one service for another; and
- e. Other relevant considerations.

199 IAC 5.6(1). The rules also specify additional criteria the Board may consider in determining whether a service or facility should continue to be subject to service quality regulation, notwithstanding the existence of effective competition. See 199 IAC 5.6(2).

The Board has adopted these rules to assist in determining where effective competition exists. The factors described in these rules are consistent with well-established economic theories regarding competitive markets that have been widely used, in one form or another, by nearly all states. The determination of effective competition in a market, compared to the simple presence of multiple providers, is significant to an analysis for deregulation, since competition must be sufficient to prevent anti-competitive behavior upon deregulation. Thus, a finding of effective competition means that the current level of competition is sufficient to discipline prices and ensure reasonable service quality without active regulation by the Board.

In the absence of effective competition or regulation, unregulated monopolies would be able to raise prices to unreasonable levels. Moreover, without effective competition an unregulated provider with some monopoly power could engage in predatory pricing; that is, it could reduce prices in markets where it faces competition. The result would be to drive any potential competitors out of the market and deter others from entering. Therefore, a determination of effective competition is required before a service or facility can be deregulated and regulatory constraints lifted.

In considering whether a communications service is subject to effective competition and can be deregulated, the Board has recognized there is no single factor or criterion that is determinative. Instead, the Board has considered and balanced a number of factors, as described in previous orders regarding deregulation. (See the orders cited in footnotes 1 and 2.) In addition, the Board has reviewed the standards applied by other states that have conducted formal competition analyses for intrastate telecommunications markets. Based on a report published by the National Regulatory Research Institute (NRRI) in October 2003,¹² at least 33 states have completed some form of competition analysis using, among other factors, the following indicators for effective competition: market share, the number of CLECs providing service, the quality of service provided, the number of interconnection agreements, wholesale rates, UNE rates, the number of CLEC switches or collocation points, customer satisfaction measurements, and retail price comparisons for basic services.¹³ Any of these factors can be relevant in determining whether a particular communications service or facility is subject to effective competition and can be deregulated.

¹² "State Analysis of Competition in the Telecommunications Markets: Results of an NRRI Survey," NRRI Report, October, 2003. The NRRI survey may be viewed at www.nrri.org.

¹³ *Id.*

ISSUES

1. Whether Effective Competition Exists in the Named Overbuilt Exchanges.

A. Statutory Analysis

1. Whether a comparable service or facility is available from a supplier other than the telephone utility.

In the overbuilt exchanges, CLECs have constructed their own networks, which overlap a significant portion of the existing incumbent's local wireline facilities. This allows the CLEC to furnish local exchange services to customers independent of the incumbent. Overbuilds have been completed by a variety of CLEC's, including cable companies and municipal telecommunications utilities. The majority of facility overbuilds, however, involve the construction of network facilities only within the urban areas of these exchanges. For the most part, the rural areas surrounding these overbuilt communities continue to have voice service provided only through the incumbent's facilities, either by the incumbent or by a CLEC that leases these facilities.

The record demonstrates that in all of the named overbuilt exchanges (with the exception of Belle Plaine) a facilities-based CLEC is providing local exchange service that appears to be comparable to that of the service offered by the incumbent. (Tr. 1260-71, 1512.)¹⁴ The Board has previously noted that the standard at issue here does not require that identical services or facilities be offered, only that

¹⁴ Coon Creek, the CLEC in Belle Plaine, offered testimony that in the Belle Plaine exchange, construction on Coon Creek's facilities is not to be completed until 2005. (Tr. 1512).

comparable or substitutable services or facilities be available. (See Iowa Telecommunications Services, Inc., d/b/a Iowa Telecom, "Order Denying Petition for Deregulation," Docket No. INU-01-1, April 5, 2002.) Because comparable services or facilities are generally available in these exchanges from a telecommunications provider other than the incumbent, using either ILEC or CLEC facilities or a combination of both, the Board finds that this statutory criterion has been met.

2. Whether market forces are sufficient to assure just and reasonable rates without regulation.

The record confirms that the CLECs in these communities are offering local service in competition with the incumbent service providers and have acquired market shares greater than 50 percent for both residential and business customers. This circumstance has generally resulted in a division of the market between two carriers, even if other CLECs are present, and demonstrates the potential for a duopoly market in these exchanges.

In prior orders (discussed below), the Board has expressed concern that in markets where two competitors effectively share the market, deregulation could lead to duopoly price behavior entailing price collusion or price predation followed by monopoly pricing. Either situation may result in a decrease in competition, rather than an increase.

The Board's concern about deregulation of duopoly markets is largely based on economic theories that suggest three, four, or even five providers may not be enough to justify a finding of effective competition. These market power measures

include the Herfindahl-Hirschmann Index (HHI) and the Landes-Posner Index (LPI). These competition measures, which rely heavily on a structural analysis of the market, are useful in merger and antitrust analyses. In its initial order of this proceeding, however, the Board questioned whether these measures are useful in evaluating local exchange service competition for purposes of deregulation. Instead, the Board suggested that in this setting the best use of the measures utilized by HHI and LPI may be to track changes in market shares over time for the Board's consideration, along with other evidence such as the number of competitors, level of advertising, pricing, ease of entry, line loss data, and customer loss data.

Moreover, the HHI and LPI were developed for use in a different context, that of merger and antitrust analysis in markets that typically lack a regulatory presence like the Board. As such, the Board expressed the hypothesis that these particular tests were designed to ensure the existence of a competitive marketplace where there is no ready regulatory alternative and should not be as rigorously applied in this context. The comments submitted in this proceeding did not seriously challenge this idea and the Board concludes that the hypothesis is correct.

It is true, as noted above, that the Board has expressed its concerns regarding duopolies in at least two previous deregulation dockets. In both cases, the Board declined to deregulate based, at least in part, on these concerns. See In re: U S West Communications, Inc., "Order Denying Petition to Deregulate," Docket No. INU-99-3, March 1, 2000 (the U S West docket); In re: Iowa Telecommunications

Services, Inc., d/b/a Iowa Telecom, "Order Denying Petition for Deregulation," Docket No. INU-01-1, April 5, 2002 (the Iowa Telecom docket). Nevertheless, the Board has revisited the duopoly issue in this docket. The Board now finds that there are significant differences between the competitive environments in these overbuilt markets at this time and the markets previously considered by the Board, such that the potential duopoly issues do not require denial of deregulation.

The U S West and Iowa Telecom dockets are distinguishable from the present situation. The U S West docket involved an ILEC in an adjoining exchange (South Slope) that constructed new facilities to serve relatively small parts of the U S West exchanges in Coralville and Cedar Rapids, Iowa. U S West requested deregulation of its local exchange services throughout those communities, arguing that the presence of South Slope in parts of each exchange amounted to effective competition in the entirety of the exchanges. The Board denied U S West's request, finding that it was impractical to deregulate only the small parts of these exchanges where South Slope was competing with U S West. The Board also found that limited competition in a small part of an exchange was insufficient to justify deregulation of the entire exchange. As there was no evidence that South Slope intended to expand its facilities to serve other parts of the exchanges at issue, there was no basis for deregulation of the entire exchanges.

The Iowa Telecom case involved a petition to deregulate nine exchanges where Iowa Telecom was experiencing competition. Seven of those exchanges are

also being considered in this proceeding. The record in that proceeding demonstrated that in each of the nine exchanges there was only one local service competitor with no reasonable prospect of additional CLEC entry. The Board denied Iowa Telecom's petition, concluding that having only two telephone companies in each of the exchanges created a duopoly that would not provide effective competition or assure reasonable rates without regulation.

In this proceeding, the circumstances in overbuilt markets are different and require some additional analysis to determine whether market forces are sufficient to overcome the Board's duopoly concerns and ensure just and reasonable rates without regulation. Most of these exchanges have two facilities-based wireline providers of local exchange service, with the exception of Harlan, which has three, and it is unlikely there will ever be more than two wireline facilities-based providers in these exchanges given their small size and the high cost of building a new local exchange network. The Board agrees with Consumer Advocate that looking only at the number of wireline carriers, and ignoring all other relevant factors, most of these markets would be considered duopoly markets. (Tr. of 10/19/2004, p. 137, hereinafter "Tr. 13".)

Based on this description, several parties voiced concerns over the possibility that the incumbent in these exchanges could engage in predatory pricing schemes.¹⁵

¹⁵ See IAMU Brief, pp. 6-8; Cox Iowa Brief, p. 13; F&B Brief, pp. 13-14; Forest City Brief, p. 3; South Slope Brief, pp. 7-17.

The record also demonstrates, however, that when all of the relevant factors are considered, these are not traditional duopoly situations. In these specific exchanges, the CLECs are small enough that their success in the market depends upon being responsive to their local customers. Moreover, the CLECs in these exchanges are municipal companies, cooperatives, or small locally-owned corporations serving fewer than 15,000 customers. As such, they are not subject to rate regulation under Iowa law. This is because they are already subject to other pressures that tend to keep their rates reasonable, even if they faced no competition at all. Municipals and cooperatives are controlled by their customers, so they have little or no incentive to charge excessive rates. Small locally-owned companies are also responsive to local influences that historically have been sufficient to deter excessive rates, even in monopoly markets. These factors will continue to be effective in duopoly markets. Based on the unique features of these specific overbuilt exchanges, the Board finds that there are sufficient market forces in place in these exchanges at this time to ensure just and reasonable rates without regulation.

Moreover, in each of these markets the non-rate regulated CLEC has gained a market share of over 50 percent, yet the Board continues to regulate the rates of the ILEC, which has lost market share. It is difficult to justify continued regulation of the ILEC's rates when it no longer has a majority of the market and when there is good reason to believe that the new market leader will not exercise whatever market power it may have.

Finally, there are other market forces in place in the form of other services being provided, including, but not limited to, wireless and Voice-over Internet Protocol (VoIP), that provide a constraint on prices even if they are not adequate substitutes for all customers. For all of these reasons, the Board finds these markets are not traditional duopoly markets and are distinguishable from the situation in the Iowa Telecom case.

Still, there is a possibility of predatory pricing by a deregulated ILEC. The Board will address that concern through its market monitoring mechanism and its power to re-regulate, if necessary, pursuant to § 476.1D(6)-(9). The market monitoring mechanism will be discussed in greater detail below, after discussion of the deregulation criteria in the Board's rules.

B. The Criteria of 199 IAC 5.6(1)

1. Whether a single provider has the ability to determine or control prices.

The record shows that in addition to having a smaller market share, the incumbents in these exchanges often, but not always, charge higher prices than the CLECs. This information, coupled with the previous discussion regarding non-market constraints on CLEC prices, indicates that no single provider has the ability to determine or control prices in these exchanges. Nevertheless, the Board intends to continue to monitor prices in these markets and will react appropriately if there is any attempt by one provider to determine or control prices.

2. Whether other providers are likely to enter the market.

The record demonstrates that given the small size of these markets and the high cost per customer to build a new wireline local exchange network, the likelihood of additional facilities-based wireline competitors entering these markets is minimal. The record reflects that in at least three exchanges, no new or additional CLEC providers have entered these exchanges since 1999. Some participants assert that the presence of two existing competitors in these small markets will serve as a deterrent to any further market entry. (F&B Brief, pp. 17, 20.)

However, the Board agrees with Iowa Telecom and others that the ILECs in bordering exchanges, as well as cable television providers and municipal utility companies, all serve as additional sources of potential competitive entry. (Iowa Telecom Brief, p. 15; Tr. 1537-38, 1553, 1558, 1570.) While the likelihood that another facilities-based wireline competitor will enter these markets may be diminished, the Board finds it is very likely that these exchanges will see, or have already seen, entry from wireless providers and from other nascent technologies, such as VoIP through cable, DSL, or broadband-over-power lines.¹⁶

¹⁶ The Board considers these technologies to be relevant factors in the Board's analysis for determining the potential for future competition, even though they may not be considered "effective competition" at this time.

3. Whether there is substitutability of one service or facility for another.

This issue was addressed in the discussion regarding the availability of comparable services, above.

C. Summary

The Board finds that there is not sufficient evidence in the record to support a finding of effective competition in the Belle Plaine exchange. The record shows that Coon Creek has not yet overbuilt the Belle Plaine exchange and, therefore, there is not a facilities-based competitor in place in that exchange at this time. In addition, the record demonstrates that the incumbent exchange services in the Conrad and Steamboat Rock exchanges were recently transferred from Iowa Telecom to Heart of Iowa Communications Cooperative (Heart of Iowa), a non-rate-regulated company. This transfer makes this deregulation proceeding irrelevant in those exchanges, as they will not be rate-regulated after the transfer is completed.

The Board finds that there is sufficient evidence in the record to support a finding of effective competition in the remaining 19 overbuilt exchanges and, therefore, the Board will deregulate rates for local exchange services in these exchanges. The Board will continue to monitor these markets to ensure that the consumers in those markets are adequately protected from anticompetitive pricing behavior. This monitoring will be in the form of regular competition surveys designed to collect information regarding market share, facility interconnection, and the pricing of comparable services. In addition, the Board will require that companies in these

markets provide the Board with after-the-fact notice of all changes in prices within a reasonable time after the new prices are offered to the public. Receipt of this information on a regular basis will allow the Board to observe market occurrences and provide a degree of flexibility in reacting to noticeable changes in competition, with its available remedies, including re-regulation if necessary, for any determined abuse of market power. At the same time, by restricting the information requirements to after-the-fact filings, the burden on the competitors will be minimized.

Iowa Code § 476.1D(5) provides that the Board may deregulate rates but continue service quality regulation if the Board determines that the service in question is an essential communications service and the public interest warrants continued service regulation. The Board finds that local exchange service is an essential communications service, it is the very basis of telecommunications service in these communities. In addition, the Board finds that upon deregulation of these exchanges, there are public interest concerns regarding each carrier's obligation to provide local voice services throughout its defined service area, in both urban and rural parts of the exchange. Therefore, the Board will exercise its authority under § 476.1D(5) and will continue to regulate service quality in these exchanges in the same manner as all other certified ILECs and CLECs that provide local exchange service in Iowa.

Finally, Iowa Code § 476.1D(2) and 199 IAC 5.7 require that when a service or facility is found to be subject to effective competition, deregulation is not complete

until the carrier files, and the Board approves, a deregulation accounting plan. In previous deregulation dockets, the Board has not required an accounting plan because the affected carriers were operating under price regulation plans and no benefit was to be gained by the filing of accounting plans for the services involved. Under those circumstances, the filing of an accounting plan would have served no useful purpose. However, in this proceeding, at least one participant, IAMU, has argued that an accounting plan is necessary. Therefore, the Board will not waive the accounting plan requirement in this proceeding. The Board will require that ILECs in these exchanges submit a cost allocation manual in the manner suggested by Iowa Telecom (See Tr. 65) before deregulation will be effective in these exchanges. If, however, a company does not already have a cost allocation manual that would be appropriate for this purpose, the Board will consider any proposed alternative to determine whether the alternative contains sufficient information to satisfy the statutory requirement.

2. Whether Effective Competition Exists in the Council Bluffs Residential and Business Markets.

A. Statutory Analysis

1. Whether a comparable service or facility is available from a supplier other than the telephone utility.

The record demonstrates that several providers are offering comparable residential local exchange services throughout the Council Bluffs residential and business markets at rates that are comparable to the incumbent's. Qwest is the

incumbent provider in this market and maintains a slight majority share in both the residential and business markets. Forty-eight certificates have been issued to CLECs to provide service in the Council Bluffs market, with approximately 20 of them currently serving end-users through some combination of UNE, UNE-P, or resale service leased from Qwest or through their own facilities. (Tr. 612-14.) Cox Iowa, for example, serves a substantial percentage of the residential service market in Council Bluffs as well as a considerable percentage of business service through its own cable network. The record also demonstrates that Cox Iowa's network overlaps nearly all of Qwest's network in Council Bluffs. (Tr. 1587.)

The number of CLECs providing residential and business service in Council Bluffs, coupled with the high degree of overlap by Cox Iowa's facilities and Cox Iowa's success in the market, indicates that there are comparable services or facilities available in the Council Bluffs residential and business markets from a telecommunications provider other than the incumbent. Therefore, the Board finds that this statutory criterion has been met.

2. Whether market forces are sufficient to assure just and reasonable rates without regulation.

Despite the apparent availability of comparable services throughout the Council Bluffs residential and business markets, some participants expressed concern that if local exchange services in the Council Bluffs markets were to become deregulated, Qwest and Cox Iowa would be able to engage in either predatory

pricing or price following, driving other competitors from the market. (Tr. 1587-88, 1594-95; Consumer Advocate Brief, p. 8.)

In response, Qwest argues that the CLECs in Council Bluffs will not be driven from the market because competition is simply too well-developed. (Qwest Brief, p. 5). The Board agrees. The record supports a finding that the widespread presence of Cox Iowa, as well as the presence of a significant number of smaller CLECs throughout the Council Bluffs market, creates a competitive environment where market forces are active and sufficient to ensure just and reasonable rates.

The Board shares the concern of several participants regarding the recent petition Qwest filed with the FCC, seeking forbearance from enforcement of the requirements of 47 U.S.C. § 251(c).¹⁷ If Qwest's petition is granted by the FCC, Qwest would no longer be obligated to provide CLECs in the Council Bluffs market with access to UNEs. The fact that this petition is currently pending before the FCC increases the level of uncertainty for competitors in the Council Bluffs market.

However, it is likely that there will be a certain level of uncertainty in the local exchange marketplace for the foreseeable future. The Board cannot wait for all questions to be resolved (which may never happen) and still fulfill its statutory duty to deregulate services and facilities that are currently subject to effective competition. The Board will proceed with its determination in this docket, despite the pending FCC action, because there are substantial CLEC providers in this market, including a

¹⁷ "In the Matter of Petition of Qwest Corporation for Forbearance Pursuant to 47 U.S.C. § 160(c) in the Omaha Metropolitan Statistical Area," DA 04-1869 in WC Docket No. 04-233, filed June 21, 2004.

major facilities-based provider. The Board finds that this statutory criterion is satisfied; there are sufficient market forces in place in the Council Bluffs residential and business markets at this time to ensure just and reasonable rates without regulation.

B. The Criteria of 199 IAC 5.6(1)

1. Whether a single provider has the ability to determine or control prices.

The Board addressed this issue in the preceding discussion regarding the presence of market forces that are sufficient to assure just and reasonable rates without regulation. The Board finds that the presence of Cox Iowa and a significant number of other CLECs throughout the Council Bluffs market creates a competitive environment where no single provider has the ability to control prices.

2. Whether other providers are likely to enter the market easily.

Based on this record, it appears it is unlikely that another wireline competitor will enter the Council Bluffs residential or business market, primarily due to the cost and uncertainty. Ease of entry using Qwest's facilities may be adversely affected by the FCC's decision on Qwest's petition for forbearance, but that is only a possibility; to date, there are a number of CLECs providing local exchange service through the use of UNEs or resale. While the likelihood that another facilities-based wireline competitor will enter these markets may be small, the Board finds the likelihood that the Council Bluffs residential and business markets has and will see entry from

wireless providers and from other nascent technologies, such as VoIP using cable, DSL, or power lines, is certain.

3. Whether there is substitutability of one service or facility for another.

This issue was addressed in the discussion regarding the availability of comparable services.

C. Summary

The Board finds that there is sufficient evidence in the record to support a finding of effective competition in the Council Bluffs residential and business markets and, therefore, the Board will deregulate the rates for local exchange service throughout this community. Nevertheless, the Board will continue to monitor these markets to ensure that Iowa consumers are adequately protected from anticompetitive behavior. This monitoring will be in the form of regular competition surveys and after-the-fact price change filings, as described earlier in this order.

The Board also finds that because local exchange service is an essential communications service and due to the public interest concerns regarding a carrier's obligation to provide local voice services throughout its defined service area, the Board will exercise its authority under § 476.1D(5) and continue to regulate service quality in the Council Bluffs residential and business markets in the same manner as all other certified ILECs and CLECs that provide local exchange service in Iowa.

Finally, the Board will require that providers in the Council Bluffs residential and business markets submit a cost allocation manual (or an approved alternative) in

lieu of a traditional accounting plan, as required by statute and as described earlier in this order.

3. Whether Effective Competition Exists in the Sioux City Business Market.

A. Statutory Analysis

1. Whether a comparable service or facility is available from a supplier other than the telephone utility.

The record in this proceeding indicates that comparable local business services are being offered in the Sioux City business market by various service providers at comparable rates. Qwest is the incumbent provider in this market and maintains a majority share of the business service connections. There are 48 certificates issued to CLECs for the provision of service in the Sioux City market, with approximately 20 of them currently serving end-users, either by purchasing wholesale services from Qwest in whole or in part or by using their own facilities. (Tr. 612-14). The number of CLECs providing business service in the Sioux City market indicates that there are comparable services or facilities available in the Sioux City business market from one or more telecommunications providers other than the incumbent. Therefore, the Board finds that this statutory criterion has been met.

2. Whether market forces are sufficient to assure just and reasonable rates without regulation.

In the Board's May 7 order initiating this proceeding, the Board noted that the results from the 2003 telecommunications survey showed that the top two competitors in the Sioux City business market served between 45 and 50 percent of

the market.¹⁸ The 2003 survey results also indicated that FiberComm was utilizing its own network in Sioux City while McLeod, another CLEC in the market, used UNE-P and resale from Qwest to provide service.

The record in this proceeding demonstrates that the amount of network overbuilding in the Sioux City market by competitors is actually more limited than it appeared from the survey responses. FiberComm states that it purchases loop facilities from Qwest to provide nearly all of its services except for facilities that have been built to serve the city of Sioux City offices, Terra Center, and the Plymouth Block Building. (Tr. 1589.) FiberComm indicates that only 20 percent of the loops it uses to provide services are from its own facilities; the remaining 80 percent are UNEs purchased from Qwest. (Tr. 1589.)

Given this information from FiberComm, the record demonstrates that the facilities-based competition in the Sioux City business market is not extensive. The Board included the Sioux City market in this proceeding based on information from the 2003 competition survey that indicated the existence of a substantial CLEC network in that market. The information received through this proceeding, however, demonstrates that the competitors in the Sioux City market provide service primarily using UNEs purchased from Qwest. Because of this information, the Sioux City market no longer fits the parameters of this phase of the proceeding and is beyond the scope of the Board's initial notice. Thus, there is no basis for the Board to find, at

¹⁸ In re: Deregulation of Local Exchange Services in Competitive Markets, "Order Initiating Notice and Comment Proceeding," Docket No. INU-04-1 (May 7, 2004), p. 13.

this time, that market forces in Sioux City are sufficient to ensure just and reasonable rates for business local exchange service without regulation.

Because one of the statutory criteria to determine the presence of effective competition is not met, the Board finds that there is not sufficient evidence in the record to support a finding of effective competition in the Sioux City business market at this time. Therefore, the Board will not deregulate local exchange service in the Sioux City business market. Because the statutory criteria has not been met, it is unnecessary to address the criteria of 199 IAC 5.6(1).

4. Whether Effective Competition Exists for the Deregulation of Residential Second Lines.

A. Statutory Analysis

1. Whether a comparable service or facility is available from a supplier other than the telephone utility.

In its order of May 7, 2004, the Board suggested that market for residential second lines might be subject to effective competition and requested comments concerning current uses for residential secondary lines, the market share relationships among these uses, and the total price comparison between residential second lines and wireless or broadband service packages that might serve similar purposes. (Initial Order, p. 25.) However, little useful information was provided in response to that request. Qwest asserts that it has experienced a drop in the number of secondary residence lines it sells in Iowa; the company states that these were initially installed primarily for dial-up computer use and it believes the decline is due

to the replacement of those lines by digital subscriber line (DSL) service and cable modems. (Tr. 629; Qwest Initial Brief, p. 13.) Similarly, Frontier states that it has experienced difficulty retaining second lines due to displacement by high-speed Internet connections and wireless service. (Tr. p. 15.) However, neither of these participants quantified or substantiated their claims regarding the number of lines lost or the substitution of secondary lines with services such as DSL or wireless. The evidence fails to establish a connection between unquantified loss of secondary lines and the alleged substitute services. Based on this record, it is just as likely that some or all of the lost secondary lines are due to economic factors.

Other participants state that wireless service is not an adequate substitute for residential second lines because of its sporadic availability in rural areas and uncertain service quality. Likewise, these participants did not provide any substantive evidence to support this position; they offer only opinion testimony.

Therefore, the record is inconclusive as to whether a comparable service or facility is available from a supplier other than the telephone utility for residential second lines. None of the parties submitted adequate evidence to allow the Board to make a finding with respect to residential second lines. The Board finds that there is not sufficient information available in the record to demonstrate that there is a comparable service or facility available for residential second lines.

Because one of the statutory criteria to determine the presence of effective competition is not met, the Board finds that there is insufficient evidence in the record

to support a finding of effective competition for residential secondary lines at this time. It is unnecessary to continue the statutory analysis regarding this issue.

ORDERING CLAUSES

IT IS THEREFORE ORDERED:

1. The rates for local exchange service in the following Iowa exchanges, Laurens, Mapleton, Spencer, Storm Lake, Whiting, Armstrong, Coon Rapids, Delmar, Forest City, Harlan, Lowden, Oxford, Oxford Junction, Primghar, Saint Ansgar, Solon, Stacyville, Stanwood, and Tiffin, are deregulated pursuant to Iowa Code § 476.1D, as described in this order.
2. The rates for local exchange service in the Council Bluffs residential and business markets, as defined in this order, are deregulated pursuant to Iowa Code § 476.1D, as described in this order.
3. The deregulation of rates for these services shall be effective upon the Board's approval of a cost allocation manual or alternative accounting plan pursuant to Iowa Code § 476.1D(2).
4. The Board will continue to monitor the markets identified in this order through the use of competition surveys at regular intervals to be determined by the Board described in this order. Further, all ILECs and CLECs offering service in these exchanges shall file with the Board a notice of all price changes they implement in these exchanges. The notice should be filed no later than 21 calendar days after the

price change is first made available to the public. The filing may take the form of an original letter to the Executive Secretary, accompanied by ten copies.

5. The Executive Secretary of the Board is directed to cause a notice, in the form attached to and incorporated by reference in this order, of the deregulation ordered herein to be published in the Iowa Administrative Bulletin.

UTILITIES BOARD

/s/ Diane Munns

CONCURRENCE OF ELLIOTT G. SMITH

I concur in full with the majority decision reached by the Iowa Utilities Board (IUB) in this docket. It follows the guidelines established by the General Assembly within the Iowa Code for the Board to use in determining whether communications services are subject to effective competition. I believe the deliberations of the Board in this matter were respectful and thorough, reaching a conclusion that satisfies legal precedent and is based in fact --- with an eye on effecting further deregulation should market developments warrant.

That said, I can understand the frustration of those who advocate for greater deregulation of communication services within this state. The statutory framework under which the Board's deliberations are to occur rests in language that first appeared in the Code, in certain instances, over 40 years ago. One can argue that the basic regulatory structure of the Board goes back even further, first emerging in

1878 when the Iowa Utilities Board's predecessor, the Iowa Board of Railroad Commissioners, was established. Since that time, the approach employed to look after the public interest regarding telecommunications issues can be viewed as one of predicting market behavior and anticipating the potential for inappropriate corporate action.

An alternative method of oversight would allow the forces of a free market to operate, effecting regulatory consequence on an undesirable situation after-the-fact. In essence, the choice of regulatory principle is either trying to guide the behavior of market actors by dictating what will and will not be tolerated in the marketplace, or incenting the desired behavior by withholding operation of traditional regulatory authority as long as a continued showing of good corporate citizenship and fair treatment of customers is evidenced. One might say it comes down to whether government regulates by fiat based on premonition or by responsive oversight based on actual circumstance.

Telecommunications industry analysts and observers note that the jurisdictional province of state-law-based regulation is under assault. Its viability in a global, Internet protocol-based communications world is no longer certain. Methods of transporting voice and data are integrating and becoming more mobile. Several distinct technologies can now transmit calls of comparable reach and quality worldwide, making traditional local, state, and national boundary lines nearly irrelevant. Identifying the origin or termination point of a call is becoming more

difficult, bringing into question the current federal and state access charge and reciprocal compensation schemes.

Needless to say, the telecommunications industry sits at a crossroad. Today's marketplace supports multiple networks that offer a variety of competing services, yet these operate within the parameters of laws designed years ago to regulate a single network providing traditional wireline telecommunications services. The time is ripe for state lawmakers to re-orient Iowa communications laws by giving the Board clear authority to deploy a lighter regulatory touch that facilitates the availability of product innovation to our citizens yet utilizes appropriate market monitoring devices in the event that technological dynamism begins to overrun consumer welfare.

With these thoughts duly recorded, I reiterate my support for the decision of the majority in this docket and respectfully acknowledge the statement made in dissent.

/s/ Elliott Smith

**CONCURRING IN PART AND DISSENTING IN PART
MARK O. LAMBERT**

I concur with most of the decision of the majority of the Board in this matter, but I would go further and deregulate business service in the Sioux City market and residential second lines, statewide, as well. It is my hope that we will re-examine these markets in Phase 2 of this proceeding.

First, I believe the evidence in this record is sufficient to justify deregulating business lines in Sioux City. The testimony and evidence show that there is a significant level of competition in Sioux City, with comparable services being offered at comparable rates. The incumbent, Qwest, has lost significant market share to competitors. The fact that there are 18 active CLECs serving customers in the Sioux City market demonstrates ease of entry for competitors. (Tr. 616.) The evidence demonstrates that the competitors in the Sioux City business market provide service primarily through UNE-L, with facilities-based second, and UNE-P third. (Tr. 617, 682-82, 711.) Therefore, any uncertainty regarding the future of UNE-P is not a reason to delay deregulating the Sioux City business market, since it is the competitors' least-used platform. If UNE-P is no longer a valid platform, there remains substantial, and I believe effective, competition from carriers utilizing UNE-L and their own facilities. Market forces, even discounting the UNE-P lines, are sufficient to ensure just and reasonable rates for business local exchange service without rate regulation of in the incumbent.

As I understand the majority's discussion of this issue, they have decided not to deregulate the Sioux City business market at this time at least partly because of a potential notice problem. Specifically, the Board included the Sioux City business line market in Phase 1 of this proceeding because it appeared to meet certain screening criteria. Based on the Board's survey results, it appeared the CLECs had captured substantial market share and they had done so primarily using their own

wireline facilities. As the record developed, it became clear that the CLEC facilities were not as extensive as the Board initially believed. Thus, it could be argued that the Sioux City business line market was incorrectly included in Phase 1 and, as a result, was not truly eligible for deregulation at this time. I do not necessarily agree with that analysis, but more importantly, I see it as a problem that, if it exists, can easily be cured in Phase 2 now that we have a better understanding of the facts and circumstances.

Second, I would deregulate residential second lines, statewide. Sufficient evidence was presented in this docket to demonstrate to me the existence of effective competition for this service. Both Qwest and Frontier provided testimony that they have lost a significant number of second lines and that those losses are primarily attributable to wireless competition, with some losses as a result of competition from high-speed Internet connections. (Tr. 629-31.) Qwest provided considerable data in support of its testimony that second lines are being lost to wireless competition, including two surveys (Ex. RHB-11A and RHB-11B) and testimony regarding Qwest's internal tracking system. That system shows that in the time since August 2002, 20 percent of the Qwest customers in Iowa who have disconnected lines have cited wireless substitution as their reason for disconnection. (Tr. 542.) Thus, the evidence shows that wireless service is an effective substitute for many residential second lines. The sizeable loss of second lines to wireless

providers demonstrates that market forces are sufficient to assure just and reasonable rates without regulation, in my opinion.

With respect to this issue, I read the majority opinion as saying, in effect, that the Board still believes residential second lines may be subject to effective competition, but the record made in Phase 1 lacks sufficient reliable evidence of a connection between the reduced sales of second lines and the use of substitute services like wireless and broadband. Reasonable minds may disagree on the question of the sufficiency of the existing evidence, but I am confident that if we renew notice of this market for possible deregulation in Phase 2, a record can be made that will be persuasive to my colleagues, as well.

Thus, I concur in the Board's decision to deregulate the overbuilt exchanges and the residential and business markets in and around the Council Bluffs exchange. I would go further and deregulate Sioux City business lines and statewide residential second lines, as well. Failing that, I believe those markets should be included in Phase 2 of this proceeding.

/s/ Mark O. Lambert

ATTEST:

/s/ Judi K. Cooper
Executive Secretary

Dated at Des Moines, Iowa, this 23rd day of December, 2004.

UTILITIES DIVISION [199]

NOTICE OF DEREGULATION

Pursuant to Iowa Code § 476.1D (2003), the Utilities Board (Board) gives notice that on December 23, 2004, the Board issued an order in Docket No.

INU-04-1, In re: Deregulation of Local Exchange Services in Competitive Markets, deregulating the rates for local exchange service in the Council Bluffs business and residential markets, as defined in the Board's order, as well as in the following Iowa exchanges: Laurens, Mapleton, Spencer, Storm Lake, Whiting, Armstrong, Coon Rapids, Delmar, Forest City, Harlan, Lowden, Oxford, Oxford Junction, Primghar, Saint Ansgar, Solon, Stacyville, Stanwood, and Tiffin. The Board's findings are more fully discussed in the order, which may be obtained from the Board by calling 515-281-5563 or on the Board's web site, <http://www.state.ia.us/iub>.

December 23, 2004

/s/ Diane Munns

Diane Munns
Chairperson